

Amended Adoption Tax Credit & Exclusion

The Economic Growth and Tax Relief Reconciliation Act (Public Law 107-16) was enacted on June 7, 2001. Among other things, the law amended tax benefits for parents who adopt a child by increasing the maximum tax credit and exclusion available and extending benefits to families with higher incomes than previously allowed. In addition, the law made the tax credit and exclusion permanent and applied the adoption credit against the alternative minimum tax.

Adoption Tax Credit

The adoption tax credit is available in the tax year that the adoption is finalized. In tax year 2003, a family that adopts an eligible child and has a modified adjusted gross income of less than \$152,390 (up from \$150,000 in 2002) may claim an adoption tax credit of up to \$10,160 (up from \$10,000 in 2002), depending on their expenses. To claim the credit, the family must document that they have incurred certain qualified expenses that are not reimbursed from another source. A family that otherwise meets the criteria but earns between \$152,391 and \$192,389 will be eligible for a credit in an adjusted amount based on their income.

Beginning in tax year 2003, the law alters the criteria for a family that adopts a child with special needs only. Such a family that earns less than \$152,390 may automatically claim a credit of \$10,160 regardless of their actual qualified expenses. Families who earn between \$152,391 - \$192,389 will receive an adjusted credit based on their income, regardless of their actual expenses. Such families must still document their actual expenses and the fact that the State has determined that the child is special needs.

Adoption Benefit Exclusion

The law extends the exclusion from income for employer-provided adoption assistance, so that a family is not liable for taxes on adoption benefits provided through work. The maximum exclusion is increased to \$10,160 per eligible child, including special needs children. The amount of the exclusion will be adjusted for families with incomes between \$152,391 and \$192,389. Beginning in 2003, families who adopt children with special needs may qualify for the exclusion regardless of their actual adoption expenses.

Definitions

Qualified expenses are reasonable and necessary adoption fees, court costs, attorney's fees, and other expenses that are directly related to the legal adoption of a child other than a spouse's child.

An eligible child is either: (1) under the age of 18; or (2) an individual who is physically or mentally unable to care for him/herself.

A special needs child is a citizen or resident who a State has determined: (1) cannot or should not be returned to the home of the birth parents; and (2) has a specific factor or condition (such as the child's ethnic background, age, or membership in a minority or sibling group, or the presence of factors such as medical conditions, or physical, mental, or emotional handicaps) because of which the child cannot be placed with adoptive parents without adoption assistance.

DISCLAIMER: This summary was prepared by the Children's Bureau and should not be used as official guidance on tax law. Adoptive families should contact the IRS or a tax advisor for information on the credit or exclusion.